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C O N F I D E N T I A L SECTION 01 OF 03 SANTO DOMINGO 004979

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SUBJECT: DOMINICAN BANKING #12: MORE BANK FRAUD, THIS TIME
AT PROGRESO

REF: SANTO DOMINGO 4610

11. (U) This is number 12 in a series of cables on the
Dominican banking sector.

More Bank Fraud, This Time at Progreso

(SBU) Another Dominican bank has turned up a potentially huge
and probably fraudulent hole in its balance sheet, despite
the IMF-mandated improvements in banking laws and
supervision. The bank's board, which includes some of the
wealthiest business families in the country, has moved
quickly to assemble funds to cover their exposure, so as to
keep the bank viable. The outcome remains uncertain.

(C) The owners of the Banco del Progreso, with about 10
percent of the deposits in the Dominican banking systems,
learned on the last weekend in October they had unexpected
additional liabilities totaling about 5 billion Dominican
pesos, equivalent to more than USD 150 million. They met
immediately with other leading bankers and with government
authorities but said nothing to the public. On November 1
the board announced without comment the appointment of
Roberto Bonetti as the new bank president and Manuel Diez as
the new chairman of the holding company Grupo Progreso.
Pedro Castillo, formerly president both of the bank and of
Grupo Progreso, dropped out of public view and has reportedly
traveled to the United States.

(C) The immediate worry in the administration and in banking
circles was that precipitate revelation of the apparent loss
would cause a run on the bank that could degenerate into
unmanageable pressures on the banking system. Pedro Castillo
reportedly had gone to Listin Diario newspaper with a
defensive version of the facts but we have been told that
Director General of Customs Miguel Cocco effectively warned
the paper late on Sunday, October 30, not to run the story.
Cocco is said to have telephoned Listin owner and Baninter
defendant "Ramoncito" Baez directly. Cocco passed the same
message to other papers.

The Scam

(C) Those well acquainted with the events indicate that the
banking reforms instituted at IMF advice had dealt with bank
surveillance but had not yet instituted new or adequate
controls on bank holding companies. These reforms are
scheduled for implementation in July, 2006. Castillo is said
to have taken advantage of his dual presidency of the bank
and Grupo Progreso to issue from the holding company in
2003-2004 a large amount of commercial paper. This was
irregular but not technically illegal. The Progreso Group,
however, openly carried about 3 billion pesos' worth (USD 90
million) on the bank's books. We have learned that the IMF
had earlier urged that the banking authorities to oblige the
Group to "unwind" these liabilities.

(C) The Grupo Progreso board commissioned a special review
after getting hints from staff that something was wrong.
Their Boston-based forensic audit consultant told them that
the total of the outstanding commercial paper was 8 billion,
not 3 billion -- a completely unexpected increase in
liability by more than US 150 million. There is apparently
little indication of where the money went; all of the
commercial paper is redeemable upon maturity by presentation
to the bank. Paper for a full 5 billion pesos falls due this
month.

(C) Progreso's leading shareholders include members of the
prominent Viccini, Bonetti, and Perello families. They say
that they are paying out of pocket proportionately large sums
to help cover the liabilities with at least US \$150 million.
The government-owned Banreservas has agreed to a bridge loan
of 1.3 billion pesos (about US\$ 43 million) to meet immediate
needs, a fact confirmed to the Charg by Technical Secretary
of the Presidency Temistocles Montas. These contributions
may have reduced the risk of a run on the bank; a board

members says that a number of those who have redeemed paper have redeposited their funds with the bank. But rumors and information about Progreso's problems are circulating widely and freely.

(SBU) Unknown for now are the identities of the approximately 2500 holders who acquired the paper as private placements through the group's subsidiary Provalores.

(C) Progreso President Pedro Castillo had told the board he was issuing commercial paper to take advantage of the opportunity to arbitrage between interest rates available there and Central Bank certificates of deposit, which hit unprecedented highs a year ago. CB rates have steadily fallen since that time. A leading board member says that they weren't informed of the amounts and the board did not follow the matter closely. This person told us that only very little of the money, if any at all, went into Central Bank paper; funds probably went into bad loans, servicing interest, and Castillo's personal purchases. When he left, Castillo walked out with the files but failed to gather copies held elsewhere in the bank. Board members intend to have him prosecuted.

(C) IMF resident representative Ousmene Mandeng acknowledged to us on November 4 the seriousness of the unexpected gap in Progreso financing and said that the Fund has been in close consultation with the banking authorities. In contrast to the situation of the time of the 2003 bank failures, the Dominican Republic now has in place its Law on Systemic Risk that obliges the authorities to take action as required, including, if necessary, direct intervention in the bank to prevent a run, to guarantee continuing operations, and to prevent financial contagion. A previously scheduled IMF team arrived on November 7, headed by Guy Meredith and including three members from the IMF's monetary and exchange division. They called on the Chargé on November 9 and undertook to consult further, later in the week.

Context and Implications -- Not Good

(SBU) The Progreso revelations occur just as a U.S. civil court has sentenced Baninter-affiliated businessman Luis Alvarez to pay USD 174 million in restitution and damages for laundering money through U.S. banks, and accusations against "Ramoncito" Baez and confederates have been sent for criminal trial in the Dominican Republic. One effect is that these events, positive in themselves for the pursuit of justice, become a backdrop for yet more of a story on fraud and banking corruption -- emphasizing the worst possible aspects of the country for international investment. They also indicate once more the enduring risk incurred by any pension funds, which by law must be invested in Dominican commercial banks.

(C) Progreso shareholders appear to have demonstrated unexpected tenacity and forthrightness in their dealings to date -- immediately informing other leading banks and putting together a rescue plan while hiring a top-level international firm to handle the public relations for recovery. Board members invited leading press editors to lunch on November 8 as a major step in managing public perceptions. The November 9 press coverage focused on new president Bonetti's assurances that the bank is strong and his comment that Castillo left because of "differences of policy." The Q&A exchanges recorded in the article in on-line journal www.clavedigital.com show that Bonetti had been very carefully coached to provide a maximum of reassurance, a minimum of controversy, and no numbers at all. A lawyer from the defense team for "Ramoncito" is quoted in Listn, goading banking authorities to tell the public more.

(C) The government comes out less well. Progreso board members met President Fernandez on November 3 to inform him, just before Fernandez departed for the OAS Summit in Argentina. Fernandez was understandably non-committal and he declined their request to order a "no-fly" lookout for Castillo, who had not been charged. But banking authorities failed to ensure adequate handling of the matter over the course of months; Cocco's overnight intimidation of the media might have been understandable for initial prudential management of risk, but in fact the news shutdown lasted for more than a week. Banking Superintendent Camilo and Finance Minister Bengoa both denied on November 7 that anything untoward was going on at Banco Progreso, assertions that should earn them noses like Pinocchio. Technical Secretary Montas commented to the Chargé and USAID Director on November 7, "If everything goes well, the public might never have to know how much money is involved."

12. (U) Drafted by Michael Meigs.

13. (U) This report and others in the series are available on the classified SIPRNET at

<http://www.state.sgov.gov/p/wha/santodomingo/> along with
extensive other material.
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